



IT IS SO ORDERED.
Signed June 30, 2014

A handwritten signature in cursive script, reading "Arthur S. Weissbrodt", is written over a horizontal line.

Arthur S. Weissbrodt
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re]	Case No. 11-56921-ASW
]	
]	
VICTOR TALOSIG DE LEON and]	
IMELDA FAJARDO DE LEON,]	Chapter 11
]	
Debtors.]	Trial Date: February 24, 2014
]	

MEMORANDUM DECISION AND ORDER ON MOTION TO VALUE LIEN

The Debtors, Victor Talosig De Leon and Imelda Fajardo De Leon ("the Debtors"), filed a motion asking this Court to determine the value of their residence located at 1350 Country Club Drive in Milpitas, California ("the Property"). The purpose of the motion is to avoid a junior mechanic's lien in the amount of \$25,350 held by JP Paving and Grading ("the Creditor"). At a trial held on February 24, 2014, the Debtors were represented by attorney Marc Voisenat, and the Creditor was represented by David Siegel.

The Debtors contend that the value of the Property is less than the amount owed to the holder of the first deed of trust, JP Morgan Chase ("the Bank"). The parties do not dispute that the Bank's lien is in the amount of \$2,253,668.32. However, the

1 parties disagree as to whether the Property is worth more than that
2 amount.

3 In this regard, both parties have offered testimony and
4 competing appraisals from licensed appraisers. Appraiser Mark Ivie
5 testified on behalf of the Creditor and opined that the Property
6 has a value of \$2,750,000, which is approximately \$500,000 over the
7 amount owed to the Bank. Appraiser Patrick McElroy testified on
8 behalf of the Debtors and opined that the Property has a value of
9 \$2,050,000, which is roughly \$200,000 less than what is owed to the
10 Bank. Exhibits 1, 2, 3, B, C, and D were offered and admitted as
11 evidence.

12 For the reasons which follow, the Court finds the Creditor's
13 evidence of value more persuasive than the Debtors' evidence, and
14 concludes that the Property's value is greater than the amount owed
15 to the Bank. This Memorandum Decision constitutes the Court's
16 findings of fact and conclusions of law, pursuant to Rule 7052 of
17 the Federal Rules of Bankruptcy Procedure.

18
19 **I. Findings of Fact**

20 The Debtors filed their bankruptcy petition under chapter 11
21 on July 25, 2011. The Creditor filed a proof of claim on November
22 15, 2011, and an amended proof of claim on December 9, 2011. The
23 Creditor's claim is in the amount of \$25,350, and is a mechanic's
24 lien for asphalt and concrete work, secured by the Property.
25 Neither the proof of claim nor the amended proof of claim states
26 the value of the Property. The mechanic's lien is junior to the
27 first deed of trust held by the Bank in the amount of
28 \$2,253,668.32, as stated in the Bank's proof of claim.

1 **A. Testimony and Appraisal of Mark Ivie**

2 The Creditor retained Mark Ivie to appraise the Property. Mr.
3 Ivie is a certified residential real estate appraiser who works in
4 Santa Clara County at Mark Ivie Appraisal Services. Mr. Ivie has
5 worked for more than 30 years in the appraisal business, and has
6 performed approximately 20 appraisals per month during that time.
7 Mr. Ivie estimated that Mr. Ivie has done more than 6,000
8 appraisals during his career, and that he has testified in court up
9 to 30 different times.

10 According to Mr. Ivie, Mr. Ivie appraises residences and small
11 income-producing properties. However, most of Mr. Ivie's
12 appraisals are of single-family residences.

13 Mr. Ivie conducted an appraisal of the Property. Mr. Ivie's
14 appraisal of the Property was an exterior-only appraisal. Mr. Ivie
15 did not request access to the interior of the Property. Instead,
16 Mr. Ivie visited the Property on November 21, 2013, drove to the
17 foot of the Property's driveway, examined public information about
18 the Property, looked at Google maps of the Property, and looked
19 down onto the Property from a ridge above the Property.

20 Mr. Ivie testified that when Mr. Ivie was hired to conduct the
21 appraisal, Mr. Ivie was not told what the purpose of the appraisal
22 would be. Mr. Ivie also stated that Mr. Ivie would have turned
23 down the assignment if anyone had given him a pre-determined value
24 for the Property.

25 Relying on public records, Mr. Ivie stated that the Property
26 has a gross living area of 7,781 square feet and sits on a 6.1 acre
27 parcel in the hills of Milpitas. Mr. Ivie believed that the
28 Property was completely finished, and stated that the Property was

1 surrounded by a fence. According to Mr. Ivie's appraisal, the
2 Property was six years old at the time of the appraisal, has a view
3 of the bay and city lights, and has a five-car garage.¹ Mr. Ivie's
4 appraisal also stated that the Property has five bedrooms and four
5 and a half bathrooms.²

6 In the appraisal, Mr. Ivie used a market data approach to
7 value the Property. Using this approach, Mr. Ivie used similar and
8 comparable properties to come to a value, making adjustments for
9 distinguishing features such as lot size, quality, condition,
10 number of bedrooms, number of bathrooms, gross living area (meaning
11 the size of the residential structure), and location. However, Mr.
12 Ivie did not make adjustments for age and explained that Mr. Ivie
13 did not think an age adjustment was necessary after looking at
14 statistics and the MLS, and because the age of the Property was
15 similar to the age of the comparables. In this appraisal, Mr. Ivie
16 assigned the Property a value of \$2,750,000 as of November 21, 2013
17 -- approximately three months prior to the trial on the Debtors'
18 motion.

19 Mr. Ivie compared the Debtors' Property with six other
20 properties. In selecting the comparable properties, Mr. Ivie
21 looked for properties sold within six to eight months prior to the
22 inspection date of November 21, 2013, and up to five miles away
23

24 ¹ By contrast, Mr. McElroy's appraisal stated that the
25 Property has a six-car garage. The photographs included with Mr.
26 McElroy's appraisal include a picture of four garage doors, two of
27 which lead to double parking spaces, and two of which lead to
single parking spaces. It thus appears that the Property has a
six-car garage.

28 ² Mr. McElroy's appraisal also stated at pages 1, 3, and 5
that the Property has 5.1 bathrooms. The "tenth" of a bathroom was
not explained.

1 from the Property. Mr. Ivie stated that Mr. Ivie looked for
2 similar properties within that five-mile radius, but discovered
3 that there were not a great deal of closed sales in the area.
4 Therefore, Mr. Ivie expanded Mr. Ivie's search to include
5 properties with different gross living areas. After making this
6 expansion, Mr. Ivie found only four properties initially, two of
7 which were sold properties (comparables #2 and #3), and two of
8 which were current listings (comparables #5 and #6). When Mr. Ivie
9 expanded the search to include a 24-month time frame, Mr. Ivie
10 found between ten and twenty sales. Of these, Mr. Ivie used two as
11 comparables (comparables #1 and #4).

12 Of the comparables selected by Mr. Ivie, Mr. Ivie testified
13 that three comparables (#1, #2, and #5) were 6,500 square feet or
14 greater. As a result, Mr. Ivie opined that the Property is not too
15 large for the neighborhood and not "overbuilt." However, Mr. Ivie
16 acknowledged that there were no sales of properties in the area
17 which were larger than, or equivalent in size to, the Property.
18 Mr. Ivie also noted that there were very few homes in the area
19 which were the size of the Property or larger, and possibly fewer
20 than one percent of homes were as large as the Property.

21 Mr. Ivie did not make any adjustments for the Property's
22 proximity to a fault line. Mr. Ivie explained that there are many
23 earthquake faults in the Bay Area, and unless proximity to a fault
24 line is brought to Mr. Ivie's attention, or unless earthquake
25 insurance is required, then Mr. Ivie does not consider whether
26 there is an earthquake fault nearby.

27 Mr. Ivie also explained that Mr. Ivie's assessment of value
28 takes into account the overall utility and overall condition of

1 each comparable in comparison to the Property. This entails
2 looking at proximity to neighbors, the size of the lot, and
3 topography. When looking at properties smaller than the Property,
4 Mr. Ivie made positive adjustments for gross living area. Mr. Ivie
5 also made positive adjustments for inferior properties, and
6 negative adjustments for superior properties.

7 Mr. Ivie's comparable #1 is located at 1855 Saint Andrews
8 Court in Milpitas, California, and is only 0.63 miles from the
9 Property. Comparable #1 sold for a price of \$2,730,000 and closed
10 escrow on August 13, 2012. Comparable #1's parcel is only 0.4
11 acres, and for this reason, Mr. Ivie made a positive adjustment to
12 the sale price of \$50,000 per acre in the total amount of
13 \$285,000.³ Mr. Ivie made no adjustments for comparable #1's view,
14 which Mr. Ivie treated as similar to the Property's view. Because
15 comparable #1 is only 6,745 square feet, Mr. Ivie made a positive
16 adjustment of \$130,000 to account for the comparable's smaller
17 size. Mr. Ivie also made a positive adjustment of \$10,000 because
18 the Property has more bathrooms. Because the landscaping of
19 comparable #1 was superior to the Property, Mr. Ivie made a
20 negative adjustment of \$100,000. With a net adjustment of positive
21 \$325,000, Mr. Ivie assigned comparable #1 an adjusted sale price of
22 \$3,055,000.

23 Comparable #2 is located at 1155 Saguare Common in Fremont,
24 California, and is 3.63 miles from the Property. Comparable #2
25 sold for \$2,034,00 and closed escrow on June 19, 2013. Using the
26 \$50,000 per acre adjustment, Mr. Ivie made a positive adjustment of
27

28 ³ Mr. Ivie made this \$50,000 per acre adjustment for each
comparable with a smaller lot, regardless of topography.

1 \$170,000 to account for comparable #2's lot size of only 2.7 acres.
2 Mr. Ivie deemed the view from comparable #2 to be inferior to the
3 Property's view, and made a positive adjustment of \$102,000. Mr.
4 Ivie also made a \$50,000 positive adjustment for comparable #2's
5 inferior condition. Because comparable #2 has more bathrooms than
6 the Property, Mr. Ivie made a negative adjustment of \$40,000, but
7 also made a positive adjustment of \$92,000 because the gross living
8 area for comparable #2 was only 7,047 square feet, less than the
9 square footage of the Property. Comparable #2 also received a
10 \$20,000 positive adjustment for having a smaller garage, but
11 received a negative adjustment of \$40,000 for its pool. The net
12 adjustment was \$354,000, resulting in an adjusted sale price of
13 \$2,388,000.

14 Comparable #3 is located at 3132 Monte Sereno Terrace in
15 Fremont, California, and is 2.16 miles from the Property.
16 Comparable #3 sold for \$1,935,000 and closed escrow on May 31,
17 2013. For acreage of only 0.6, Mr. Ivie made a positive adjustment
18 of \$275,000, and for the comparable's inferior view, he made a
19 positive adjustment of \$97,000. Mr. Ivie deemed the quality and
20 condition of comparable #3 to be inferior to the Property, and made
21 positive adjustments of \$100,000 for quality and \$50,000 for
22 condition. Comparable #3 has more bathrooms than the Property, and
23 Mr. Ivie made a negative adjustment of \$20,000, but he also made a
24 positive adjustment of \$323,000 because comparable #3 has only
25 5,200 square feet of gross living area. Mr. Ivie made a \$60,000
26 positive adjustment because comparable #3 has only a two-car
27 garage, but gave a negative adjustment of \$100,000 for superior
28

1 landscaping. In all, the net adjustment was \$785,000, resulting in
2 an adjusted sale price of \$2,720,000 for comparable #3.

3 Comparable #4 is located at 3003 Woodside Terrace in Fremont,
4 California, and is 2.26 miles from the Property. Comparable #4
5 sold for \$2,257,500 and closed escrow on July 25, 2012. For its
6 0.8 acres, Mr. Ivie made a positive adjustment of \$265,000, and
7 also made positive adjustments of \$113,000 for its inferior view,
8 \$100,000 for its inferior quality of construction, \$50,000 for its
9 inferior condition, \$327,000 for its gross living area of 5,169
10 square feet, and \$40,000 for its three-car garage. Mr. Ivie made
11 negative adjustments of \$20,000 because comparable #4 had more
12 bathrooms, \$40,000 for its pool, and \$100,000 for its superior
13 landscaping. The net adjustment was \$735,000, resulting in an
14 adjusted sale price of \$2,992,500.

15 Comparable #5 is located at 664 Quince Lane in Milpitas,
16 California, and is 0.45 miles from the Property. Comparable #5 was
17 listed for sale at an asking price of \$2,788,000. Mr. Ivie made
18 positive adjustments to this price, as follows: \$250,000 for its
19 1.1 acres; \$50,000 for its inferior condition; and \$153,000 for its
20 gross living area of 6,554 square feet. Mr. Ivie also made the
21 following negative adjustments: \$40,000 for the number of
22 bathrooms; \$20,000 for a six-car garage; \$40,000 for a pool; and
23 \$100,000 for superior landscaping. The net adjustment was
24 \$253,000, for an adjusted sale price of \$3,041,000.

25 Comparable #6 is located at 3547 Vista Norte Court in
26 Milpitas, California, and is 2.19 miles from the Property.
27 Comparable #6 was listed for sale at an asking price of \$2,299,950.
28 For this comparable, Mr. Ivie made positive adjustments of \$140,000

for its 3.3 acres, \$50,000 for its inferior condition, \$223,000 for its 6,000 square feet of gross living area, and \$40,000 for its three-car garage. Mr. Ivie also made negative adjustments of \$20,000 for its additional bathroom, and \$100,000 for its superior landscaping. With a net adjustment of \$333,000, Mr. Ivie assigned comparable #6 an adjusted sale price of \$2,632,950.

Regarding comparables #5 and #6, Mr. Ivie did not know whether the current listings had sold after the appraisal was performed, and explained that it is accepted practice to use current listings when using a market data valuation approach. Mr. Ivie testified that Mr. Ivie did not make negative adjustments to the current listings in anticipation of any price drops -- meaning Mr. Ivie did not assume that the current listings would sell below asking price -- because Mr. Ivie lacked data to make a reasonable adjustment. Mr. Ivie stated that if the asking prices for the current listings had dropped, then this would affect Mr. Ivie's appraisal and would reduce the adjusted sale prices of the current listings.

The following chart summarizes the calculations made by Mr. Ivie in determining the adjusted sale price for each comparable:

Comp.	Sale/List Price	Acreage	View	Condition & Quality	Rooms	Gross Living Area	Other	Adjusted Sale Price ⁴
1	2,730,000	+285,000	none	none	+10,000	+130,000	-100,000	3,055,000
2	2,034,000	+170,000	+102,000	+50,000	-40,000	+92,000	-20,000	2,388,000
3	1,935,000	+275,000	+97,000	+150,000	-20,000	+323,000	-40,000	2,720,000
4	2,257,500	+265,000	+113,000	+150,000	-20,000	+327,000	-100,000	2,992,500
5	2,788,000	+250,000	none	+50,000	-40,000	+153,000	-160,000	3,041,000
6	2,299,950	+140,000	none	+50,000	-20,000	+223,000	-60,000	2,632,950

⁴ The average adjusted sale price of Mr. Ivie's comparables was \$2,804,908.

B. Testimony and Appraisal of Patrick McElroy

The Debtors retained Patrick McElroy to conduct an appraisal of the Property. Mr. McElroy is a general certified real estate appraiser and real estate broker. Mr. McElroy has been a licensed broker since 1978. Although Mr. McElroy has conducted appraisals since 1978, the licensing mechanism for appraisers only came into existence in 1991. Therefore, Mr. McElroy has been a licensed appraiser since 1991. Mr. McElroy is both a residential and commercial appraiser.

Mr. McElroy conducted an appraisal on January 17, 2014, approximately one month prior to the trial.⁵ Exhibit B is a copy of Mr. McElroy's January 17, 2014 appraisal. In appraising the Property, Mr. McElroy knew in advance that the appraisal would be used in the Debtors' bankruptcy case. In his appraisal, Mr. McElroy assigned the Property a value of \$2,050,000 value based on a market approach, which Mr. McElroy explained was more accurate than a cost approach.⁶

⁵ Also in evidence, by agreement of the parties, are two additional appraisals conducted for the Debtors. One is an appraisal by Mr. McElroy with an effective date of July 25, 2011, which assigned a value to the Property of \$1,875,000. The other is an appraisal by Kindra Donald of Silicon Valley Appraisal with an effective date of December 13, 2013, assigning the Property a value of \$1,800,000. Because the January 17, 2014 appraisal is more relevant given its closer proximity to any confirmation of a chapter 11 plan, and because there was no testimony about the substance of the two earlier appraisals, the Court gives no weight to the two earlier appraisals.

⁶ On cross-examination, Mr. McElroy was asked about the assessed value of the Property, which according to county records was \$2,200,000 in 2012. Mr. McElroy responded that the assessed value is based on construction cost, and that a homeowner can challenge that value with the County.

1 Unlike Mr. Ivie, Mr. McElroy examined both the interior and
2 exterior of the Property. Mr. McElroy testified that Mr. McElroy
3 measured the Property and found that the Property was over 7,900
4 square feet⁷ -- larger than the 7,781 square foot gross living area
5 used by Mr. Ivie, and larger than what is reflected in the County's
6 records.

7 Mr. McElroy testified that the appraisal of the Property was
8 hard to conduct because of the Property's size, very good quality,
9 and location in an earthquake zone. Mr. McElroy also stated that
10 it was difficult to find comparable sales. Mr. McElroy looked at
11 properties sold from the Evergreen neighborhood of southeastern San
12 Jose to the northern city of Hayward over a two-year period, yet
13 found no comparable as large as the Property. Mr. McElroy
14 explained that in conducting an appraisal, it is preferred to
15 "bracket" the appraised property with larger and smaller
16 properties, but that Mr. McElroy was unable to "bracket" in this
17 case, because the largest homes were generally in the 5,000 to
18 6,000 square foot range and were smaller than the Property. As a
19 consequence, Mr. McElroy determined that the Property was an
20 overimprovement for the area, meaning that the residential
21 structure was overly large and that the owners could not expect to
22 get full value out of it upon sale, much like with a swimming pool.

23 Mr. McElroy testified that the construction at the Property
24 had not been finalized, and that this would have a negative effect
25 on any prospective buyer. Mr. McElroy stated that there was a need
26 to obtain or renew a final permit from the City before the work
27

28 ⁷ According to the written appraisal, Mr. McElroy actually
measured the Property's living space as 7,952 square feet.

1 could be completed. When asked what work remained unfinished, Mr.
2 McElroy explained that some of the City's requirements were not
3 satisfied, that there was a need for landscaping, and that the
4 fencing needed to be replaced per the City. Mr. McElroy posited
5 that a lender might require the work to be completed before
6 approving a loan for a prospective buyer. For these problems, Mr.
7 McElroy deducted \$100,000 from the Property's value.⁸

8 Mr. McElroy described the Property's site. Mr. McElroy stated
9 that the Property sits on a steep hill and has a beautiful view of
10 the bay. There are retaining walls, concrete swells, and drainage
11 out to the street. The hill is covered with weeds and has very few
12 trees. In Mr. McElroy's opinion, it was a very expensive site to
13 develop.

14 In his most recent appraisal, Mr. McElroy used three of the
15 same comparables as Mr. Ivie.⁹ Mr. McElroy's oldest comparable was
16 only eight months stale. Mr. McElroy did not put much weight on
17 the active listings, for which the asking prices had dropped, and
18 made a 3% negative adjustment to the active listings to account for
19 the uncertainty of the final sale price.

20 Like Mr. Ivie, Mr. McElroy used six comparables in Mr.
21 McElroy's appraisal. All of Mr. McElroy's comparables were in the
22

23 ⁸ This \$100,000 adjustment was made as a negative adjustment
24 to each comparable property with superior landscaping. Mr. Ivie
25 made the exact same adjustment for comparable properties with
superior landscaping.

26 ⁹ Mr. McElroy testified that four of the comparables were the
27 same. However, a comparison of Mr. McElroy's January 17, 2014
28 appraisal and Mr. Ivie's November 21, 2013 appraisal shows that
only three comparables were the same: 1155 Saguare Common in
Fremont, California; 3132 Monte Sereno Terrace in Fremont,
California; and 3547 Vista Norte Court in Milpitas, California.

1 eastern foothills, all had bay views,¹⁰ and all were in earthquake
2 zones. Mr. McElroy did not conduct any interior inspections of the
3 comparables, and explained that Mr. McElroy very seldom sees the
4 inside of a comparable.

5 Mr. McElroy's comparable #1 is located at 4960 Sierra Road in
6 San Jose, California, and is 6.49 miles from the Property.
7 Comparable #1 sold for \$1,300,000 and closed escrow in November
8 2013. Mr. McElroy made numerous adjustments to the sale price,
9 including the following positive adjustments: \$400,000 for an
10 inferior location;¹¹ \$100,000 for the inferior quality of
11 construction; \$40,000 for its age of 28 years; \$100,000 for its
12 condition; \$20,000 for having one less bathroom; \$289,300, for
13 having a gross living area of only 5,059 square feet; \$16,000 for a
14 smaller garage; and \$20,000 under the category "patio/deck/porch."
15 Mr. McElroy also made these negative adjustments: \$24,829 for its
16 larger site of 7.27 acres; \$122,000 for "functional utility;" and
17 \$120,000 for good landscaping and a barn. With a net adjustment of
18 \$718,471, Mr. McElroy obtained an adjusted sale price of \$2,018,471
19 for comparable #1.

20 The term "functional utility" was used by Mr. McElroy to
21 account for what Mr. McElroy deemed to be the excessive -- or
22 overbuilt -- gross living area of the Property. Mr. McElroy
23 explained that properties with a gross living area of more than
24 6,000 square feet were functionally obsolete and outside the norm

25
26 ¹⁰ Mr. McElroy testified that all six comparables had bay
27 views, but later testified that the fourth comparable had a
hillside view for which Mr. McElroy made an adjustment.

28 ¹¹ The appraisal did not explain why comparable #1's location
was inferior, except to note that comparable #1 has only a one-lane
access.

1 of the neighborhood. However, Mr. McElroy only made a functional
2 utility adjustment for any comparable property smaller than 7,000
3 square feet. In selecting a cut-off point for functional
4 obsolescence, Mr. McElroy looked at surrounding properties not for
5 sale and found only a few homes larger than 8,000 square feet. Mr.
6 McElroy did not search the County's records on the MLS, although
7 Mr. McElroy admitted that he could have done such a search.¹²

8 Mr. McElroy's calculation of a \$122,000 negative adjustment
9 for functional utility was derived from the cost to build the
10 additional square footage, which Mr. McElroy estimated to be
11 approximately \$488,000 (\$250 per square foot for the square footage
12 over 6,000 square feet). Mr. McElroy took 25% of this cost and
13 converted it into the negative adjustment.

14 Comparable #2 is located at 4011 China Court in Hayward,
15 California, and is 17.28 miles from the Property. Comparable #2
16 sold for \$2,212,500 and closed escrow in July 2013. Mr. McElroy
17 made the following negative adjustments for comparable #2: \$200,000
18 for a superior location;¹³ \$122,000 for functional utility; and
19 \$100,000 for good landscaping. Mr. McElroy made the following
20 positive adjustments as well: \$40,511 for a lot size of 4.27 acres;
21 \$20,000 for having one less bathroom; \$287,000 for a gross living
22

23 ¹² On cross-examination, Mr. McElroy was asked whether Mr.
24 McElroy was aware of a sale in November 2010 on Country Club Drive
25 of a 6 bedroom, 9.5 bath house which sold for approximately
26 \$4,000,000. Mr. McElroy was not aware of such a sale, but stated
27 that it would be hard to make adjustments or to use such a property
28 as a comparable given the differences between the properties, and
that any adjustment would be "super heavy" and "suspicious."
Neither appraiser used this unidentified property as a comparable.

¹³ Mr. McElroy did not explain why the Hayward location was
superior, and the written appraisal is silent in this regard.

1 area of 5,082 square feet; and \$24,000 for a three-car garage. The
2 net adjustment was negative \$50,489, with an adjusted sale price of
3 \$2,162,011.

4 Comparable #3 is located at 1155 Saguare Common in Fremont,
5 California. It is the same property as Mr. Ivie's comparable #2.
6 Mr. McElroy made different adjustments to comparable #3's value
7 than did Mr. Ivie. Mr. McElroy made the following positive
8 adjustments: \$74,052 for the smaller lot size of 2.73 acres
9 (compared with \$170,000 added by Mr. Ivie); \$50,000 for the quality
10 of construction (for which Mr. Ivie made no adjustment); \$20,000
11 for the 20-year age of the comparable (for which Mr. Ivie made no
12 adjustment); \$50,000 for the condition of the comparable (Mr. Ivie
13 made the same adjustment); \$90,500 for the gross living area of
14 7,047 square feet (Mr. Ivie made an adjustment of \$92,000); and
15 \$16,000 for the smaller garage, at \$8,000 per stall (for which Mr.
16 Ivie adjusted \$20,000, at \$10,000 per stall). Mr. McElroy also
17 made these negative adjustments: \$100,000 for a superior location
18 because Fremont is a superior city to Milpitas and Fremont
19 generally has better schools¹⁴ (no adjustment by Mr. Ivie); \$50,000
20 for two extra bathrooms (Mr. Ivie's adjustment was \$40,000);¹⁵
21 \$50,000 for a pool (Mr. Ivie's adjustment was \$40,000); and
22 \$100,000 for good landscaping (Mr. Ivie made no adjustment). Mr.
23 McElroy's net adjustment for comparable #3 was \$552, for an

24
25 ¹⁴ Mr. McElroy conceded that Mr. McElroy did not look at
26 specific schools when making this adjustment for the Fremont
comparables.

27 ¹⁵ At trial, Mr. McElroy explained that the appraisal contained
28 an error, in that there was only one extra bathroom at comparable
#3, not two. Mr. McElroy stated that the adjustment should have
been only \$20,000, not \$50,000.

1 adjusted sale price of \$2,034,552¹⁶ (compared with Mr. Ivie's
2 adjusted sale price of \$2,388,000). Mr. McElroy made no positive
3 adjustment for the view.

4 Unlike the other comparables, comparable #3 had a guest unit.
5 Mr. McElroy stated that Mr. McElroy gave a \$50,000 value to the
6 guest unit after determining, based on the MLS, that the guest unit
7 has both a kitchen and bath. Mr. McElroy did not know the size of
8 the guest unit and did not have the MLS information with him in
9 court.

10 Comparable #4 is located at 3132 Monte Sereno Terrace in
11 Fremont, California. It is the same property as Mr. Ivie's
12 comparable #3. Mr. McElroy explained that this comparable is
13 located in a hillside gated community, not a rural community like
14 the Property. For this comparable, Mr. McElroy made the following
15 positive adjustments: \$120,855 for the 25,312 square foot site
16 (compared with a \$275,000 adjustment by Mr. Ivie); \$50,000 for the
17 inferior view (for which Mr. Ivie made a \$97,000 adjustment);
18 \$50,000 for quality of construction (for which Mr. Ivie adjusted
19 \$100,000); \$10,000 for its 17-year age (no adjustment by Mr. Ivie);
20 \$50,000 for its condition (same adjustment by Mr. Ivie); \$275,200
21 for a gross living area of 5,200 square feet (for which Mr. Ivie
22 adjusted \$323,000); and \$24,000 for a three-car garage (Mr. Ivie
23 adjusted \$60,000 for a two-car garage). Mr. McElroy also made
24 these negative adjustments: \$200,000 for a superior location of the
25 comparable (no adjustment by Mr. Ivie); \$20,000 for an additional
26 bathroom (same adjustment by Mr. Ivie); \$122,000 for functional
27

28 ¹⁶ If the error regarding the extra bathroom is considered, the
adjusted sale price should have been \$2,064,552.

1 utility (no adjustment by Mr. Ivie); and \$100,000 for good
2 landscaping (same adjustment by Mr. Ivie). Mr. McElroy's net
3 adjustment was positive, in the amount of \$138,055, for an adjusted
4 sale price of \$2,073,055 (compared with \$2,720,000 by Mr. Ivie).

5 Comparable #5 is located at 3547 Vista Norte Court in
6 Milpitas, California, and is the current property listing also
7 considered by Mr. Ivie as Mr. Ivie's comparable #6. However, at
8 the time when Mr. McElroy analyzed this comparable, the asking
9 price had dropped by \$100,000 to \$2,199,950. Because this was an
10 active listing, Mr. McElroy made a negative adjustment of \$65,999.
11 Mr. McElroy also made negative adjustments of \$122,000 for
12 functional utility, and \$100,000 for good landscaping (Mr. Ivie
13 also made this \$100,000 adjustment). Mr. McElroy also made
14 positive adjustments, as follows: \$60,766 for the 3.34 acre site
15 (for which Mr. Ivie adjusted \$140,000); \$10,000 for the 14-year age
16 (no adjustment by Mr. Ivie); \$195,200 for the gross living area
17 (for which Mr. Ivie adjusted \$223,000);¹⁷ and \$24,000 for a three-
18 car garage (Mr. Ivie adjusted \$40,000). Mr. McElroy did not make
19 the \$20,000 negative adjustment which Mr. Ivie made for an
20 additional bathroom. Mr. McElroy's net adjustment for this
21 comparable was \$1,967, for an adjusted sale price of \$2,201,917.

22 Comparable #6 is located at 514 Vista Spring Court in
23 Milpitas, California, and is located 2.52 miles from the Property.
24 The asking price for the comparable was \$1,788,000 at the time of
25 the appraisal, and because it was an active listing, Mr. McElroy
26 made a negative adjustment of \$53,640. Mr. McElroy also made

27
28 ¹⁷ Mr. McElroy testified that despite the different values
assigned by each appraiser for gross living area, statistically,
the adjustments were very close, even if within a range of \$50,000.

negative adjustments of \$122,000 for functional utility, \$50,000 for a pool, and \$100,000 for good landscaping. Positive adjustments were as follows: \$101,495 for the lot size of 1.47 acres; \$50,000 for the quality of construction; \$10,000 for the 22-year age of the comparable; \$50,000 for the comparable's condition; \$327,100 for the gross living area of 4,681 square feet; \$16,000 for a four-car garage; and \$3,000 for one less fireplace. The net adjustment was \$231,955, for an adjusted sale price of \$2,019,955.

A summary of Mr. McElroy's adjustments is depicted in the following table:

Comp.	Sale/List Price	Location & Site	Condition & Quality	Age	Rooms	Gross Living Area	Other	Adjusted Sale Price ¹⁸
1	1,300,000	+375,171	+200,000	+40,000	+20,000	+289,300	-206,000	2,018,471
2	2,212,500	-159,489	none	none	+20,000	+287,000	-198,000	2,162,011
3	2,034,000	-25,948	+100,000	+20,000	-50,000	+90,500	-134,000	2,034,552
4	1,935,000	-79,145	+100,000	+10,000	-20,000	+275,200	-148,000	2,073,055
5	2,199,950	+60,766	none	+10,000	none	+195,200	-263,999	2,201,917
6	1,788,000	+101,495	+100,000	+10,000	none	+327,100	-306,640	2,019,955

The two biggest differences between Mr. McElroy's and Mr. Ivie's appraisals were the following: (1) Mr. McElroy was of the opinion that the Property was overbuilt for the area, and Mr. Ivie disagreed; and (2) Mr. McElroy assigned a value of \$22,000 per acre (50 cents per square foot) instead of the \$50,000 per acre used by Mr. Ivie when adjusting the values of the comparables, all of which were located on smaller sites. Mr. McElroy explained that Mr. McElroy's adjustment for parcel size was based on the lesser

¹⁸ The average adjusted sale price was approximately \$2,084,993. Mr. McElroy did not explain why he selected a lower value of \$2,050,000.

1 utility of the Property's parcel, which was on a sloped site. Mr.
2 McElroy admitted, however, that as many as two acres of the
3 Property's site were flat and usable, and that Mr. McElroy did not
4 change the calculation to account for the usable portion. Also,
5 Mr. McElroy acknowledged that a sloped property can protect views
6 and offer some privacy.

7 In appraising the Property, Mr. McElroy overlooked a guest
8 unit (or cabana) measuring approximately 400 square feet. This
9 guest unit is separate from the main house, is heated, has a
10 bathroom, but has no kitchen or other facilities. Using a cost
11 approach, Mr. McElroy stated that the unit was worth approximately
12 \$20,000 to \$30,000. This guest unit should have brought Mr.
13 McElroy's appraised value of the Property to at least \$2,080,000.

14 15 **II. Conclusions of Law**

16 The Debtors' Motion is brought under 11 U.S.C. § 506(a)(1),
17 which provides:

18 An allowed claim of a creditor secured by a
19 lien on property in which the estate has an
20 interest, or that is subject to setoff under
21 section 553 of this title, is a secured claim
22 to the extent of the value of such creditor's
23 interest in the estate's interest in such
24 property, or to the extent of the amount
25 subject to setoff, as the case may be, and is
26 an unsecured claim to the extent that the value
of such creditor's interest or the amount so
subject to setoff is less than the amount of
such allowed claim. Such value shall be
determined in light of the purpose of the
valuation and of the proposed disposition or
use of such property, and in conjunction with
any hearing on such disposition or use or on a
plan affecting such creditor's interest.

27 Initially, the Debtors bear the burden of overcoming any
28 presumption that the value of the property stated in Creditor's

1 proof of claim is the correct value. See In re Postolica, No.
2 10-51522-ASW, 2012 WL 1035900 *5 (Bankr. Mar. 27, 2012) (citing In
3 re Southmark Storage Associates Ltd. Partnership, 130 B.R. 9, 10
4 (Bankr. D. Conn. 1991)); see also In re Southern California
5 Plastics, Inc., 165 F.3d 1243, 1247-48 (9th Cir. 1999) ("[T]he
6 proof of claim is prima facie evidence of the validity of the
7 claim. Although the creditor bears the ultimate burden of
8 persuasion, the debtor must come forward with evidence to rebut the
9 presumption of validity.") (Internal citation omitted). Once the
10 Debtors meet this burden, it then becomes the Creditor's burden of
11 persuasion to demonstrate the value of the collateral by a
12 preponderance of the evidence. Id. Here, the Creditor's proof of
13 claim does not provide a value for the property, so the presumption
14 is easily overcome in this case.

15 The parties agree that the Property should be valued according
16 to its fair market value. This agreement is supported by Supreme
17 Court and Ninth Circuit cases. See In re Associates Commercial
18 Corp. v. Rash, 520 U.S. 953, 960 (1997) (rejecting a foreclosure
19 value standard in the context of a chapter 13 "cram down," and
20 explaining that the value of the property was "the price a willing
21 buyer in the debtor's trade, business, or situation would pay to
22 obtain like property from a willing seller.");¹⁹ In re Kim, 130 F.3d
23 863 (9th Cir. 1997) (citing Taffi v. United States (In re Taffi),
24 96 F.3d 1190 (9th Cir. 1996)). Because this is a chapter 11 case,
25 the controlling date for valuation purposes is as close to

27 ¹⁹ Although Rash was a Chapter 13 case, the Sixth Circuit
28 Bankruptcy Appellate Panel in In re Creekside Sr. Apartments, LP,
477 B.R. 40, 55 (B.A.P. 6th Cir. 2012), observed that the valuation
method in Rash is equally applicable to Chapter 11 cases.

1 confirmation as possible. See In re Dheming, 2013 WL 1195652, *3
2 (Bankr. N.D. Cal. Mar. 22, 2013).

3 The Creditor has asserted that the value of the Property is at
4 least \$2,750,000; the Debtors contend that the value of the
5 Property is only \$2,050,000. This Court must determine only
6 whether the value of the Property exceeds the senior lien of
7 \$2,253,668.32; if so, then the Creditor's \$25,350 lien should not
8 be extinguished, because the Creditor's lien will be secured, at
9 least in part, by the Property.

10 The first main point of disagreement between the parties is
11 whether the Property is overbuilt, meaning that the gross living
12 area is so large that the value should be discounted. In this
13 regard, the Court is persuaded that the Property -- which is a
14 luxury home with at least 7,781 square feet of gross living area --
15 is unusually large for the neighborhood and also for the eastern
16 foothills in general.²⁰ The fact that both appraisers encountered
17 so much difficulty in locating suitable comparable sales is also
18 supportive of the conclusion that the Property is, indeed,
19 overbuilt. The Court therefore concludes that it was appropriate
20 for Mr. McElroy to make some adjustment for functional
21 obsolescence, and that Mr. Ivie should have made some adjustment,
22 as well.

23 However, the \$122,000 adjustment used by Mr. McElroy was not
24 supported. The Court can accept that a buyer might not be willing
25 to pay \$100 per square foot of living space over and above 6,000

26
27 ²⁰ An aerial photograph of the Property and neighboring homes
28 was included with Mr. McElroy's appraisal. Interestingly, this
photograph shows that the Property is one of several large custom
homes on large lots adorning the same rural hillside as the
Property.

1 square feet for an overbuilt residence. However, Mr. McElroy
2 derived the \$122,000 adjustment from what Mr. McElroy deemed to be
3 the cost to build the square footage over 6,000 square feet. The
4 adjustment was not tied to what a willing buyer would pay a willing
5 seller for the additional square footage on a price per square foot
6 basis. While the Court agrees that the seller of an overbuilt
7 house could not expect to recoup the entire cost of building the
8 excess square footage, Mr. McElroy did not explain why Mr. McElroy
9 heavily discounted the excess living space.

10 If the Property's gross living area is, indeed, over 7,900
11 square feet, then the \$122,000 adjustment equates to a reduction of
12 approximately \$63 per square foot, bringing the price per square
13 foot to approximately \$37 for each square foot over 6,000. This
14 dramatic reduction was not well-explained and is excessively low
15 for current market conditions. Mr. McElroy also did not explain,
16 to the Court's satisfaction, how Mr. McElroy selected 6,000 square
17 feet as the cut-off for overbuilt homes.

18 Although Mr. McElroy had difficulty finding comparables equal
19 or greater in size to the Property, there were ample comparables
20 with gross living areas of over 6,500 square feet. To the extent
21 that the appraisers selected different comparables, the Court
22 concludes that Mr. Ivie selected more suitable comparables in Mr.
23 Ivie's analysis. Indeed, three of Mr. Ivie's comparables were over
24 6,500 square feet, including one which was larger than 7,000 square
25 feet. By contrast, four of Mr. McElroy's comparables were closer
26 to 5,000 square feet, while the other two comparables were 6,000
27 and 7,047 square feet.

1 The Court is not able to determine -- with specificity -- what
2 the correct adjustment for functional utility ought to have been.
3 While a \$37 per square foot for square footage in excess of 6,000
4 square feet is palpably unreasonable, the Court would have found a
5 price per square foot of \$75 or higher to be more accurate and
6 believable. If a price of \$75 per square foot had been used for
7 square footage over 6,000, then Mr. McElroy could have made
8 negative adjustments of approximately \$48,000, rather than
9 \$122,000. This would have brought Mr. McElroy's estimated value of
10 the Property up by \$74,000 from \$2,050,000 to \$2,124,000.

11 The Court also concludes that Mr. McElroy's use of a \$22,000
12 per acre adjustment to account for differences in parcel sizes was
13 unreasonably low, for several reasons. Mr. McElroy did not
14 consider that the Property's site had at least two usable acres
15 which were flat enough to develop. In his calculation, Mr. McElroy
16 also disregarded the important positive aspects of having a sloped
17 site, such as view preservation and privacy, including long-term
18 privacy. Moreover, all of the comparables were hillside properties
19 with views. The Court concludes that Mr. McElroy selected an
20 artificially low adjustment and chose to err on the side of using a
21 lower value.

22 The Court concludes that the \$50,000 per acre adjustment used
23 by Mr. Ivie was more appropriate under the circumstances. Applying
24 such an adjustment to Mr. McElroy's adjusted sale prices -- and
25 adding \$30,000 for the guest house or cabana which Mr. McElroy
26 neglected to include in the written appraisal -- leads to the
27 following results for each of the six comparables:
28

Comp.	Sale/List Price	Location & Site	Guest Unit	All Other	Adjusted Sale Price
1	1,300,000	+343,000	+30,000	+343,300	2,016,300
2	2,212,500	-107,000	+30,000	+109,000	2,244,500
3	2,034,000	+70,000	+30,000 ²¹	+26,500	2,160,500 ²²
4	1,935,000	+77,450	+30,000	+217,200	2,259,650
5	2,199,950	+139,500	+30,000	-58,799	2,310,651
6	1,788,000	+233,000	+30,000	+130,460	2,181,460

The average of these six adjusted sale prices is \$2,195,510 -- only \$58,158.32 less than what is owed on the first deed of trust -- and does not take into account Mr. McElroy's inappropriate use of a \$122,000 negative adjustment for functional utility, which could bring the value for each comparable (except comparable #3) upwards by an additional \$74,000.

The two appraisers' selections of various adjustments -- within a range of reasonableness -- are also extremely important. Mr. McElroy acknowledged that the gross living area adjustments made by Mr. Ivie were statistically close and permissible. To account for differences in square footage, Mr. McElroy used a \$100 per square foot adjustment, while Mr. Ivie used up to \$125 per square foot. With the square footage differentials in this case, this could be as much as, or more than, a \$50,000 difference, depending on the properties being compared. For instance, Mr. Ivie made a positive adjustment of \$323,000 for the Monte Sereno Terrace

²¹ Although comparable #3 had a guest house which Mr. McElroy considered, this adjustment is needed to account for the fact that Mr. McElroy overlooked the guest unit at the Property.

²² This figure does not include the \$30,000 positive adjustment which should be made for the mistake in the appraisal regarding an extra bathroom.

1 comparable, whereas Mr. McElroy only made a positive adjustment of
2 \$275,200.

3 The adjustments Mr. McElroy made for location are somewhat
4 baffling. Mr. McElroy made negative adjustments of \$100,000 and
5 \$200,000, respectively, for the two Fremont comparables on the
6 basis that these properties have superior locations and better
7 schools, but Mr. McElroy did not examine the particular schools
8 assigned to each house and did not explain why Mr. McElroy made
9 these specific adjustments, or why the adjustments were different
10 for the two Fremont properties. Mr. McElroy also made a \$200,000
11 negative adjustment for comparable #2, located in Hayward, as
12 having a superior location, which was never explained or supported.
13 The dollar amounts used for these negative adjustments appeared to
14 be somewhat arbitrary and without specific factual support.

15 The Court is not able to divine the exact value of the
16 Property based on the two appraisals. Neither appraisal was a
17 model of perfection. For instance, Mr. Ivie chose not to make age
18 adjustments for comparables that were as many as sixteen years
19 older than the six-year old Property. However, Mr. Ivie's
20 remaining calculations were persuasive and within the realm of
21 reason. In light of the evidence, the Court finds that the
22 Creditor met its burden of persuasion and proved that the
23 Property's value exceeds \$2,253,668.32, which is the amount owed to
24 the Bank as the holder of the first deed of trust. Therefore, the
25 Creditor's lien is secured, at least in part if not in full, and
26 the Debtors' motion is denied.

27 **IT IS SO ORDERED.**

28 *** End of Memorandum Decision and Order ***

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